State of California

Board of Equalization
Legal Division-MIC: 82

M e m o r a n d u m

550.0812

To : Ms. Charlotte Paliani
Program Planning Manager (MIC: 92)

Date: August 6, 2003

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Subject: Charges for Premises, Regulation 1603
Taxable Sales of Food Products

I am responding to your memorandum, dated August 6, 2002, to Assistant Chief Counsel Janice L. Thurston, concerning Regulation 1603(h)(4). In pertinent part, your memorandum states:

> "We are requesting a legal opinion regarding the application of tax to premises charges by caterers and other providers of meals, food and drinks. We are concerned that some will interpret the recently revised Regulation 1603(h)(4) "Premises" to include the lease of premises by anyone. To ensure the regulation provisions are consistently applied, we would like to give staff and the public specific examples showing the application of tax.
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> "….
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> "If we limit the application of (h)(4) to caterers as defined in (h)(1), only sales by persons other than the facility owner would qualify…. This narrow interpretation of the subdivision would exclude situations where the seller of the food and beverages also supplies facilities – even if those facilities are not normally used for serving meals, food or drinks…."

Your memorandum then requests guidance in determining how tax applies to three different scenarios, quoted and discussed below.

Discussion

As you know, the major revisions to Regulation 1603 last year were made to subdivision (h) "CATERERS." Regulation 1603(h)(1) defines "caterer" as follows:

> "The term 'caterer' as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied

by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day."

In other words, a "caterer" by the regulation's definition cannot be the same person who supplies the premises, e.g., a hotel, restaurant, or banquet hall, but must be a person who serves meals, food or drinks on the premises of a third party, i.e., premises of the customer or premises that the customer has obtained from someone other than the caterer.

Despite this limitation in subdivision (h)(1), the language adopted at the public hearing by the Board in regard to the taxation of charges for premises talks in terms of premises provided by the same person who provides the meals, food or drinks, i.e., someone who is not a "caterer" as that term is defined in subdivision (h)(1). That language, subdivision (h)(4) "Premises" reads:

"General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be non taxable."

In order to answer your concerns, we will quote and address how the provisions of subdivision (h)(4) "Premises" apply to each of your scenarios. However, we will respond to your scenarios in a different order from the order in which you posed them.-

"<u>Facilities [similar to restaurants and hotels] often used for serving food</u>
[T]here are organizations that fall more obviously in line with the services offered at restaurants and hotels. For example, a convention center which has rooms available for catered events, or a country club that has a full bar and restaurant, as well as a large room for receptions, banquets, dances, etc. While these businesses provide services other than the selling of food and beverages (i.e., meeting rooms, golf courses), a main segment of the taxpayer's business involves the selling of meals, food and drinks. Generally, these businesses sell, prepare and serve the food themselves although customers may have the option of hiring an independent caterer. Would premises charges by these facilities be taxable?"

In this scenario you refer to the services offered by restaurants and hotels. In this regard, we note that Regulation 1603 discusses "restaurants, hotels, boarding houses, soda fountains and similar establishments" in subdivision (a). If changes were intended to be made to how tax applies to sales of food products made by restaurants and hotels, changes would have been made to subdivision (a). Thus, we do not interpret the changes added to subdivision (h)(4) as changing how tax applies to restaurant or hotel charges for premises.[1] In general, hotel and restaurant charges for premises are subject to tax

[1] This conclusion is also consistent with the fact that representatives of the hotel and restaurant industries at the First Interested Parties Meeting did not suggest any change to the law that charges for the use of their premises (whether separately stated or not) are included in the measure of tax when they provide meals, food or drinks on their own premises.

when the charges relate to an event where the hotel or restaurant serves meals, food or drinks; whereas hotel or restaurant charges for premises used for a meeting or some other event where no meal, food or drinks are served are not subject to tax.[2] We conclude that the same standard that applies to hotels and restaurants should apply to "similar establishments" such as convention centers and country clubs, which are more like hotels or restaurants than they are like aquariums, museums, zoos, wineries, horse ranches or similar facilities, which we discuss next.

> **"<u>Facilities not primarily used for serving food</u>**
> Establishments such as aquariums, museums and zoos frequently operate restaurants and snack bars, but clearly the primary purpose of the facility is not to serve meals, food and drinks. In regard to premises fees, these types of establishments often rent their facilities for catered events. The establishment may prepare and serve the food themselves, or subcontract with an outside caterer for the preparation and serving. Customers may or may not have the option of hiring an independent caterer. Would premises charges by these facilities be nontaxable under 1603(h)(4)?"

We initially note that although subdivision (h)(1) defines the term "caterer" and subdivision (h)(4) is a subsection to subdivision (h), the language of subdivision (h)(4) itself indicates that it is intended to apply to more categories than "caterers" as that term is defined in subdivision (h)(1). We reach this conclusion because the language in part discusses a situation in which a charge for premises is a guarantee against a minimum purchase of meals, food or drinks, a situation that generally would not arise unless the owner/lessor of the premises was also providing the meals, food or drinks. Moreover, the subdivision further provides that where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable. This implies that the owner/lessor of the premises may also be the provider of the meals, food or drinks, because generally only a person who is both the owner/lessor of the premises and the food and beverage provider would be in a position to set the price for both components of the contract (and thereby possibly improperly apportion more of the charge to a nontaxable component).

Since we have concluded that subdivision (h)(4) is intended to apply to more categories than "caterers" as that term is defined in subdivision (h)(1), we must further determine whether the language should be applied broadly to *any* person who rents premises or whether it is intended to be more limited in its application. We conclude that subdivision (h)(4) is intended to apply only in unusual circumstances, such as those site examples presented in your scenario and other unique settings. We interpret the language as resolving the dilemma raised when the measure of tax must be determined for a site that differs from the usual venue for a catered (here using the generic meaning of the word "catered") social event, i.e., when the event is held in a setting where meals, food or drink are not

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Subsequently, neither the hotel nor the restaurant industry was represented at the Second Interested Parties Meeting nor at the public hearing, despite numerous contacts by Board staff informing them of the meeting and hearing. It is also notable that the revenue loss estimates for both staff's and industry's proposed revisions to the regulation did not consider a loss from hotels or restaurants, presumably because hotels and restaurants were not seen as part of the proposed changes.

[2] If, however, one room is used solely for a meeting or conference, and a separate room is used solely to serve meals to the meeting or conference participants, charges for the room where the meeting or conference is held are not subject to tax.

usually, but may occasionally be, served. In other words, the premises referred to in subdivision (h)(4) are limited to premises primarily used (used most of the time) for purposes unrelated to the serving of food, meals or drinks.

The premises listed in your scenario, above, are used primarily (used most of the time) for purposes unrelated to the serving of meals, food or drinks. An aquarium primarily functions to display marine life for view by visitors; a museum primarily functions to display various objects for view by visitors; and a zoo primarily functions to display animals for view by visitors. Although such facilities occasionally may be rented as a venue for fund-raisers, social gatherings and other events where meals, food or drinks are furnished and served by either employees of the facility or by outside parties, charges for the use of the premises are not subject to tax because the primary use of the premises is for a purpose other than the furnishing of meals, food or drinks.[3]

> **"<u>Designated area of facility primarily used for serving food</u>**
> Other businesses designate specific areas of their property for events where meals, food and drinks are served (for example, a winery with a courtyard for weddings, or a horse ranch with a picnic/barbecue area). Again, the business selling the food and beverages may prepare and serve the food themselves, or subcontract with an outside caterer for the preparation and serving. Customers may or may not have the option of hiring an independent caterer.
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> "While food and beverages are not served in the designated areas on a daily basis, businesses generally advertise these premises specifically for catered events. Often the services they provide are very similar to those offered by bed & breakfast hotels or country inns. Should we look at the overall purpose of the business (e.g., making wine, boarding/training horses) or the function of the particular area of the facility? Should we consider the percentage of revenue from catered events to total revenue to determine primary use?"

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[3] Specifically on the subject of premises, at the Second Interested Parties Meeting and in a number of subsequent discussions, various motion picture industry representatives expressed opinions that charges for the use of premises *not* supplied by the customer and *not* primarily used for the service of meals, food or drinks should *not* be subject to tax. In other words, if the real property was *primarily used* (used most of the time) for purposes unrelated to the serving of meals, food or drinks, charges for the use of the real property when meals, food or drinks *were* served should not be subject to tax whether or not the facility was supplied by the customer, i.e., even if the person furnishing and serving the meals, food or drinks was not a "caterer." The industry opinion on this issue was expressed by U--- S---, V--- (which owns U--- S---), and the M--- P--- A--- of A---. Their representatives made it clear at the Second Interested Parties Meeting that the primary use concept was the critical factor they advocated should be employed to determine whether charges for the premises were taxable or not. Since no one else expressed any concern about the taxation of charges for premises (and staff and industry were unable to agree on language concerning premises), it seems likely that the language introduced by the Deputy Controller at the public hearing was drafted to address the concerns expressed by the motion picture industry representatives.

The premises described in your final scenario, above, are used primarily for a purpose other than the furnishing and serving of meals, food or drinks, i.e., as a winery or horse ranch[4]. However, in each instance, a portion of the premises is specifically made available, and perhaps specifically created, for events where meals, food or drinks are provided. In such instances, we interpret the term "premises" as it is used in subdivision (h)(4) to mean an entire facility that is only occasionally used for the serving of meals, food or drinks, i.e., *not* merely a portion of such a facility. Therefore, if the primary purpose of a specified portion of a facility is as a space for the serving of meals, food or drinks, charges for that type of area, whether the charges are separately stated or not, are subject to tax.[5] In other words, an area within a facility routinely used for catered (employing the word "catered" in its generic sense) events is not the type of "premises" contemplated by subdivision (h)(4).

The facts of each situation must be evaluated on a case by case basis. Using the facts from your scenario as an example, if a winery has a specific area designated for wedding receptions, charges for that specific area are subject to tax. On the other hand, if the bridal party has rented the entire winery for the reception, separately stated charges for the winery are not subject to tax. Another example would be a party at a large public art gallery or aquarium where there is a café. If, for instance, the local county bar association rents the café for a cocktail party, the charges for the café are subject to tax. However, if the bar association rents the entire gallery or aquarium for the cocktail party, separately stated charges for the entire gallery or aquarium are not subject to tax.

I hope that these guidelines are of some assistance.

SJ:sw

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[4] This memorandum assumes that the horse ranch is not a "dude ranch" where, similar to a hotel, guests typically stay for the night and are provided meals, food and drinks.

[5] This scenario is not dissimilar from a scenario of going to a movie studio and holding an event in the studio cafeteria with meals, food or drinks furnished and served. Charges for such an event in the cafeteria would be subject to tax, including any separately stated premises charge. On the other hand, if the event was held on a movie set with meals, food or drinks furnished and served on the set by the studio cafeteria, the separately stated premises charge would not be subject to tax.